



March 22, 2006

Mary F. Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Dear Ms. Rupp:

Re: Sixth EGRPRA Notice

Please accept the following comments submitted by the National Federation of Community Development Credit Union.

12 CFR Part 701.34

DESIGNATION OF LOW-INCOME STATUS; RECEIPT OF SECONDARY CAPITAL ACCOUNTS BY LOW-INCOME DESIGNATED CREDIT UNIONS

(a) Designation of low-income status

NCUA's current designation standard is keyed to national medians, with a limited number of adjustments for high cost areas. In our work, the Federation has found that this disadvantages credit unions working in high-cost areas outside those listed by NCUA in its regulations.

Accordingly, we recommend that NCUA consider substituting the following criterion that the Treasury Department's CDFI Fund uses for Investment Area designation:

- (i) *Within a Metropolitan Area, the median family income shall be at or below 80 percent of the Metropolitan Area median family income or the national Metropolitan Area median family income, whichever is greater; or*
- (ii) *Outside of a Metropolitan Area, the median family income shall be at or below 80 percent of the statewide non-Metropolitan Area median family income or the national non-Metropolitan Area median family income, whichever is greater*

[FR, Vol. 68, No. 23, Tuesday, Feb. 4, 2003, p. 5711]

NCUA has already borrowed the CDFI Fund's definition of Investment Area for designating "underserved" areas. Our proposed change would have the benefit of increasing uniformity of regulatory standards. Furthermore, our proposed alternative would be more equitable to high-cost areas with substantial pockets of low- to moderate-income people, a situation which we believe is more reflective of the growing suburbanization of the U.S.

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(b) Receipt of secondary capital accounts by low-income designated credit unions

The Federation has previously commented on NCUA's revision of regulations regarding secondary capital (see attachment). In particular, we have:

- objected to the recently added requirement that NCUA Regional Directors approve secondary capital plans of credit unions
- pointed to the investor-unfriendly conditions NCUA has successively added to secondary capital since its introduction, including but not limited to allowing NCUA to suspend interest and principal payments on secondary capital accounts

We find it puzzling that NCUA adopted and published final regulations regarding secondary capital almost immediately in advance of the current request for comments on regulatory burden.

12 CFR Part 705

COMMUNITY DEVELOPMENT REVOLVING LOAN PROGRAM FOR CREDIT UNIONS

Part 705.4 Program Activities

This section adds little to the purpose of the program. Requiring a credit union to "include basic member share accounts and member loan services" seems so self-evident as to be unnecessary.

705.5 Application for Participation

We are concerned less with the regulations, than with program implementation. Applicants have regularly reported to us excessive delays with approval and notification procedures; consequently, these credit unions are hard pressed to plan for various major training events, since they may not know of the availability of funds until days before the events take place.

Furthermore, credit union applicants report that NCUA staff have on occasion discouraged them from attending third-party sessions, in favor of attending trainings offered by NCUA itself. This suggests the possibility of conflict of interest.

705.6 Community Needs Plan

The Community Needs Plan was part of the CDRLP when it was originally instituted in 1980. It seems to us superfluous at this time. If the agency decides to keep this provision, we recommend that it specify procedures for public review of these plans, and the reports which are to be provided at the participating credit unions' annual meeting.

705.7 Loans to Participating Credit Unions

For several years, NCUA has had a relatively low portion of its funds on loan to credit unions. This suggests that: (a) loan terms are relatively unattractive; and/or (b) NCUA is currently over-funded for this program; and/or (c) credit unions do not have major liquidity needs.

We suggest that NCUA reconsider the structure of the loans, with the possibility of revising the structure in order to make secondary capital loans to credit unions. These loans could substantially enhance the safety and soundness of low-income credit unions.

(b) The regulations indicate that "once the [CDRLP] loan is repaid, nonmember share deposits accepted to meet the matching requirements are subject to ¶701.32." This is unnecessary and inappropriate. It discourages growth and adds unnecessary regulatory burden.

Sincerely yours,

Clifford N. Rosenthal
Executive Director

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Attach
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September 26, 2005

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Dear Ms. Rupp: Re: 12 CFR Parts 701 and 741 --
Uninsured Secondary Capital Accounts

This letter responds to NCUA's request for public comment on a proposal to allow low-income designated credit unions that offer secondary capital accounts to begin redeeming account funds when they are within five years of maturity, and to require prior approval of plans to offer secondary capital accounts.

Overview

The Federation supports NCUA's proposal regarding the redemption of accounts that no longer count as net worth. However:

- We oppose requiring prior approval of secondary accounts by regional directors.
- We urge NCUA to eliminate provisions in the proposed and existing regulations that are burdensome to low-income credit unions and/or impose inordinate risk on secondary-capital investors.
- NCUA should permit credit unions with less-than-adequate net worth ratios the ability to prepay, if this will help them generate additional income and thus build primary capital.
- The Disclosure and Acknowledgment statement should be modified to make investors aware of the prepayment risk of their secondary capital investments.

Impact on Low-Income Credit Unions

The proposed rule change will help low-income credit unions by giving them greater flexibility to manage their balance sheets, including especially net-worth requirements, by prepaying the portion of secondary capital that no longer counts as net worth. The Federation supports this provision. We commend NCUA for responding to the requests of low-income credit unions for this regulatory change.

However, the proposal imposes excessive paperwork burdens on credit unions and places excessive discretion in the hands of the agency's regional directors. The requirement of prior approval of secondary-capital plans goes beyond previous regulation; it should not be included in the final rule.

Adverse Impact on Investors

Since the introduction of secondary capital in 1996, NCUA's successive regulatory revisions to secondary capital have made it progressively more disadvantageous to investors. Admittedly, the basic structure of secondary capital as an investment subordinate to all other claims on the net worth of the credit union makes it a high-risk product. However, this risk has been unduly magnified to such a degree that secondary capital investments may virtually cease to be viable for investors.

- Since the inception of secondary capital in 1996, regulations have stipulated that secondary capital, once captured to cover losses, may never be replenished, even if a credit union returns to solvency. NCUA should eliminate this provision.
- NCUA's rule, adopted in 2000, stipulates that the agency may, at its sole discretion, suspend payments of dividends and principal to secondary-capital investors. This provision should be repealed.

The current proposal, by allowing credit unions to unilaterally redeem portions of secondary capital, adds prepayment risk to the credit, regulatory, and other risks borne by investors.

We do not believe that the interests of low-income credit unions would be well served by discouraging virtually all secondary capital investment; secondary capital has aided many credit unions to achieve safe, robust growth. Nor do we believe that the share insurance fund would be well served by effectively eliminating secondary capital: investors have already absorbed more than \$1 million in losses that otherwise would have had to be paid out by NCUSIF.

We recognize NCUA's role in protecting the interests of the Share Insurance Fund and of credit unions. However, some attention needs to be paid to investor interests, lest secondary capital become so utterly risky and disadvantageous as to discourage any secondary capital investment whatsoever. We urge NCUA to restore a degree of balance between the needs of credit unions, the NCUSIF, and investors

A section-by-section analysis follows.

701.34 Designation of low income status; Offering of secondary capital accounts by low-income designated credit unions

(b) Offering of secondary capital accounts by low-income designated credit unions

(1) Secondary capital plan.

The existing rules do not require a secondary capital plan to be approved by NCUA. It is argued in the Supplementary Information that secondary capital “played a role in masking the magnitude of other problems,” leading to a number of liquidations, and that consequently, approval of a secondary capital plan is appropriate.

We disagree. We believe that NCUA should reexamine its supervisory procedures rather than adding an additional burden on credit unions. To our knowledge, examiners routinely analyze capital ratios of credit unions both with and without secondary capital. There is no reason for secondary capital to “mask” the magnitude of other problems. Some of the losses referred to by NCUA undoubtedly involved fraud and/or major record keeping deficiencies. Requiring an approved plan will not eliminate fraud. Recordkeeping deficiencies should ordinarily appear in the course of an examination, regardless of the presence or absence of secondary capital. Consequently, we believe that requiring an approved plan will increase the paperwork burden on low-income credit unions without improving safety and soundness or reducing NCUSIF losses.

Finally, we would note that investors have absorbed losses on secondary capital that have *reduced* losses that the NCUSIF would otherwise have incurred on failures of credit unions with secondary capital.

(7) Availability to cover losses.

The regulation should clarify that credit unions may not use any portion of its secondary capital to pay a dividend to members or others. Dividends are not, and should not, be considered “operating losses,” but only can be paid if a credit union has available earnings.

We urge NCUA to withdraw its categorical prohibition on restoring or replenishing a secondary capital account that has been depleted. Subsequent events such as receipt of grants or reversal of charged-off loans may provide a credit union with sufficient capital to repay a secondary capital loan and thereby restore its credit-worthiness.

(12) Prompt Corrective Action

We urge NCUA to retract its prohibition on paying principal, dividends, or interest on uninsured secondary capital accounts established after August 7,

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2000. This provision inordinately increases an investor's risk in making a deeply subordinated secondary capital loan to a credit union.

) Redemption of secondary capital

(1) Request to redeem secondary capital.

This paragraph should be rewritten to provide greater clarity -- specifically the language stating that requests "must be submitted in writing on an annual basis..." Is the intended meaning that a request *may* be submitted only once in a year?

- (i) Credit unions other than those "adequately capitalized" should also be granted approval to redeem secondary capital, if doing so will improve their profitability and help them to rebuild primary capital.

Secondary capital is often priced higher than deposits (which is altogether reasonable, given the high risk and long maturities of secondary capital.) However, interest payments on secondary capital may drain income that a credit union could otherwise use to rebuild primary capital. Therefore, we urge NCUA to consider requests from low-income credit unions below the two top capital categories to repay secondary capital ahead of schedule.

- (vi) While we do not object to the requirement that a LICU's board adopt a resolution to redeem secondary capital, we are unclear about the reference in the Supplementary Information to "possible conflicts of interest between LICU officials and officials of the SC account holder." Most secondary capital investments are made by investors or funders that are entirely separate from the credit union -- e.g., banks, foundations, and government agencies. The proposed language should either be clarified or eliminated from any final document.

(2) Schedule for redeeming secondary capital.

When there is less than one year to maturity on a secondary capital investment, the remaining 20% of the original investment should be redeemable any time during that final year, to ensure consistency with the rest of the schedule.

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Appendix to 701.34

Disclosure and Acknowledgment

We agree that disclosures to investors must be maximally transparent, detailed, and properly executed both by the credit union and the investor. The disclosure must be conformed to the final rule issued by NCUA. By our reading, the proposed Disclosure and Acknowledgment fails to clearly identify the prepayment risk that this proposed rule entails for a potential investor. We urge NCUA to include this information in a revised Disclosure and Acknowledgment statement.

The Federation appreciates the opportunity to comment on this important regulation, and would be pleased to provide any additional information required by your review.

Sincerely yours,

Clifford N. Rosenthal
Executive Director

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